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SUPREME COURT, U. S.
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Supreme Court of the United States

OCTOBER TERM, 1942

No. 24

MARINE HARBOR PROPERTIES, INC.,

Petitioner,

against

MANUFACTURERS TRUST COMPANY (Successor by merger to The Mortgage Corporation of New York), as Trustee for the benefit of certificate holders in mortgage guaranteed by Bond and Mortgage Guarantee Company, Guarantee No. 181,568,

Respondent,

MAURICE RUBINGER, Trustee of Marine Harbor Properties, Inc.,

SAMUEL SILVERMAN, Additional Trustee of Marine Harbor Properties, Inc.,

MORTIMER RUBENSTEIN, Foreclosure-Receiver, and

SECURITIES AND EXCHANGE COMMISSION.

BRIEF OF PEOPLE OF THE STATE OF NEW YORK, AMICUS CURIAE

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SECURITIES AND EXCHANGE COMMISSION.

BRIEF OF PEOPLE OF THE STATE OF NEW YORK, AMICUS CURIAE

The People of the State of New York submit this brief as *amicus curiae* because they have a two-fold interest in the subject of this litigation. The Securities and Exchange Commission, in its brief, and the dissenting judge in the

Circuit Court maintain that the interests of creditors would not be best subserved in the pending State Court proceeding. The State of New York is submitting this memorandum to direct this Court's attention to the important steps taken by the State of New York for the protection of mortgage certificate holders. The analysis of the history and development of the State Court procedure over a period of ten years will show that the legislative and administrative safeguards provided in such proceedings for the protection of mortgage certificate holders (the only parties interested in the instant case) are more effective than those contained in Chapter X of the Bankruptcy Law with respect to the peculiar local problems here involved. This, coupled with the fact that the creditors in a Chapter X proceeding will necessarily be put to considerable and needless expense and delay in a Chapter X proceeding, which must, in the circumstances of the instant case, prove futile, will demonstrate that the interests of mortgage certificate holders would be best subserved in the pending State Court proceedings. The State of New York is further interested because the Superintendent of Insurance of the State of New York, acting as liquidator of various title and mortgage companies for the benefit of creditors of those companies, owns certificates in excess of $1,000,000 which will be affected by this litigation.

Opinions Below

The opinion of the District Court (Bright, D. J.) is contained in the record (R. 70-75) and is also reported in 41 F. Supp. 814. The majority (Swan, C. J., and Chase, C. J.) and dissenting (Frank, C. J.) opinions of the Circuit Court of Appeals are contained in the record (R. 107-126) and are also reported in 125 F. (2d) 296.

Jurisdiction

The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

Statutes Involved

Section 141 of Chapter X of the Bankruptcy Act (11 U. S. C., Sec. 541) provides:

"§ 141. Petition of Debtor.

Upon the filing of a petition by a debtor, the judge shall enter an order approving the petition, if satisfied that it complies with the requirements of this chapter and has been filed in good faith or dismissing it if not so satisfied."

Section 146 (11 U. S. C., Sec. 546) provides in part as follows:

"§ 146. Good faith of Petition.

Without limiting the generality of the meaning of the term 'good faith', a petition shall be deemed not to be filed in good faith if—

* * * * * * *

(3) it is unreasonable to expect that a plan of reorganization can be effected; or

(4) a prior proceeding is pending in any court and it appears that the interests of creditors and stockholders would be best subserved in such prior proceeding."

Statement of the Case

The relevant facts are set forth in the brief of the Manufacturers Trust Company, as Trustee, and in the majority opinion (R. 106-111) and will not be here repeated.

Question Presented

The question herein is whether, under the above statute (Sec. 141 of Chap. X of the Bankruptcy Act) a corporate mortgagor, with no assets other than an improved parcel of real property which is encumbered by a certificated first mortgage larger in amount than the value of the said property, may force the holder of said mortgage into a Chapter X proceeding where proceedings have already been had under State statutes specifically designed to safeguard the rights of first mortgage certificate holders and in which proceedings the debtor has participated.

Argument

We shall not discuss herein the various arguments made in the brief of the respondent Manufacturers Trust Company, as Trustee. We believe the points it makes are well taken and we rest upon them. We shall, however, place our emphasis upon the adequacy of the State Court proceedings to protect creditors of the type here involved. In our opinion, the conclusions stated in the following excerpt from the prevailing opinion (R. 110) are correct and should be sustained in this Court:

> "But the debtor made no attempt to bring its proposals to the attention of the state court in the pending proceeding, as we think it was entitled to do as an 'interested party'; had it done so its proposals, with the court's approval, could have been presented to the certificate holders. That proceeding provides adequate means to reorganize the mortgage and protect the rights of all certificate holders whose interests alone exhaust the debtor's property."

We contend that the interests of certificate holders will best be subserved in the pending State Court proceedings and that there is no necessity for any further reorganization.

We shall show to this Court that the State of New York, as a matter of legislative policy, has been deeply concerned for more than nine years with the protection and reorganization of the rights of guaranteed mortgage certificate holders and that this duty of the State to certificate holders has been and is being discharged in an able and efficient manner by the Bureau of Trust Supervision and the liquidating trusts appointed by the State Supreme Courts. The transfer of these proceedings to the Federal Court is unnecessary and will result in additional expense and delay to the certificate holders. Because of the peculiar complexity of this local problem, it is in the certificate holder's interest that it be permitted to solved in the pending State Court proceedings.

The Securities and Exchange Commission, in its brief, states that the emergency statutes enacted by the State of New York recited as their purpose the protection of the guaranty companies against claims on guarantees. This is not the case. These statutes had as their main objective the protection of the rights of certificate holders. A reading of the statutes would so demonstrate very clearly (see *McKinney's Unconsolidated Laws*, Secs. 4801, 4871). The debtor-petitioner is guilty of the same misconception in its brief. Nor do we understand the debtor's claim that certificate holders were brought into the State Court against their will. More than 66⅔% of the certificate holders actually consented (R. p. 10).

The statement is made in the dissenting opinion which indicates that the dissenting Judge believed the certificate holders in the State Court proceedings not to be at all informed or protected as to their rights. This argument will be met later in this brief (p. 15).

The Securities and Exchange Commission in its brief claims that under the New York laws there are lacking almost all of the basic safeguards for the protection of security holders as found in Chapter X. It will be shown that this claim is entirely without basis, as is also the criticism of the State Court proceedings by the dissenting Judge.

The Securities and Exchange Commission did not appear in this proceeding until after the District Court had rendered its decision. The Commission and the debtor make the argument, in common with Judge Frank of the Circuit Court of Appeals, that the adequacy and desirability of the pending proceedings in the State Court must be proved by the trustee, but that the advantages of the proceedings under Chapter X follow as a matter of course and need no proof.*

In our opinion, the burden of proof was on the petitioner to show that the pending State proceedings would not best subserve the interests of creditors. However, the issue of the efficacy of the State proceedings having been raised, we believe that the present state of the record makes it advisable for the State of New York to submit, for the information of the Court, the history of the steps taken by the Legislature, by the Courts and by the administrative officers of the State of New York, all in the interests of the creditors. The facts stated are taken from public records compiled during the course of administration by the various departments of the State government and on file, available for public examination.

FIRST: The interests of creditors will be best subserved in the State Court proceedings.

Outline of the Mortgage Guarantee Business

The guaranteed mortgage business was confined almost exclusively to the City of New York and its neighboring communities. The properties which underlie the guarantees were similarly located. The problem is not nation-wide—it is a local problem confined mainly to the metro-

* It should be pointed out that because of the failure of the Securities and Exchange Commission to intervene in the District Court the record is not ideally suited to the determination of the underlying question in this appeal.

politan area in the State of New York (see Note, 34 Columbia L. Rev. 664). The general method of doing business was for the guaranty company to make mortgage loans with its funds and then to sell the mortgages or certificates therein to investors with its guarantee. The companies reserved to themselves the right to administer the mortgages. The securities issued by these companies fell generally into two classes: (a) guaranteed whole mortgages, where a single mortgage, with guarantee, was sold in its entirety to an investor; and (b) guaranteed participation certificates, where fractional shares were sold in a single mortgage or in a group of mortgages.

The instant case concerns itself with the certificated type of guaranteed mortgage and not with the guaranteed whole mortgage.

Activity of the Legislature and of the Superintendent of Insurance

Acting under Article XI (now Art. XVI) of the Insurance Law of this State and Chapter 40 of the Laws of 1933, the Superintendent of Insurance took over the guaranty companies for rehabilitation in August of 1933, when, because of general economic distress in the real estate field, these companies were unable to meet the obligations of the guarantees. On December 31, 1933, there were outstanding approximately 20,000 guaranteed mortgages against which certificates had been issued and which were held by more than 200,000 persons. The aggregate of principal amount was $815,610,435.35 (*The Administration of Delinquent Title and Mortgage Guaranty Companies*, by George S. Van Schaick, May 10, 1935, p. 18, exhibit; Report to the Governor dated August 5, 1934, by George W. Alger, Commissioner, Appendices IV and V). In anticipation of the takeover of the certificated mortgages by the State, the Legislature enacted the Schackno Act (L. 1933, Ch. 745; *McKinney's Unconsolidated Laws*, Secs. 4871-4881), which became effective May 3, 1933, more than a year prior to Section 77-B of the Bankruptcy Act and more than five years prior to Chapter X of the Bankruptcy Act.

The State felt that it had a duty to protect the more than 200,000 certificate holders. The Legislature, in the concluding paragraph of the declaration of fact and policy in the Schackno Act, declared:

> "It is therefore hereby declared to be essential for the public interest to provide a procedure under which such bonds, mortgages or other security may be liquidated in an orderly manner and under which the assets of the guaranty corporations may be administered and conserved equally and ratably in the interests of holders of mortgage investments."

The Schackno Act (L. 1933, Ch. 745, Sec. 1) created a new remedy which was necessary to protect the rights of a vast number of certificate holders to prevent the demoralization of the real estate market, the wiping out of the equities of certificate holders and of owners and the general disruption of the financial structure (*Wolff* v. *Mortgage Commission*, 270 N. Y. 428, 432). This Act vested in the Superintendent of Insurance certain of the powers theretofore exercised by the guaranty companies, which powers included "provisions for safeguarding the interests of groups of holders of mortgage investments until a plan can be devised for permanent administration of these investments" (*Matter of People*, 264 N. Y. 69, 91). This statute made it possible to make effective such a plan for permanent administration by providing that after a hearing upon a proposed plan or agreement, upon twenty days' notice, the Supreme Court could approve such plan, which would become effective upon the consent of holders of two-thirds of the principal amount of the mortgage investment. The statute also recognized that the Court passing upon the plan should obtain the benefit of the judgment and experience of the administrative officer who had taken over the administration of these investments by providing that "the Superintendent should indicate to the Court whether or not he approves or disapproves such plan or agreement" (*McKinney's New York Unconsolidated Laws*, Sec. 4876(2)).

The Superintendent of Insurance created a Title and Mortgage Rehabilitation Bureau to supervise the administration of the title and mortgage companies in rehabilitation, including the certificated mortgages guaranteed by the companies (*The Administration of Delinquent Title and Mortgage Guaranty Companies*, supra, p. 20).

From September, 1933, to May 1, 1935, when the administration and control of the certificated mortgage issues were turned over to the Mortgage Commission (later described), mortgages in the principal amount of $324,850,161.59 had been partially or wholly reorganized by the Superintendent of Insurance (*The Administration of Delinquent Title and Mortgage Guaranty Companies*, supra, p. 43).

On April 27, 1934, a joint legislative committee was appointed to study the guaranteed mortgage situation. This committee recommended legislation to further the State's policy of relieving the unfortunate economic plight of the certificate holders and providing for the permanent administration of those investments.

Leg. Doc. 1934, Nos. 120, 121.

In 1934, the Legislature enacted a series of statutes to permit certificate holders to obtain loans on their certificates up to 25% of the face amount thereof (L. 1934, Chs. 912, 913, 914). The Governor of the State of New York, in his message to the Legislature on April 6, 1934 (Leg. Doc. 1934, No. 80), said:

> "These certificates are held by hundreds of thousands of people. Many of these people are of modest means. Some are destitute. Most have little experience with investments. All these conditions render the certificate holders particularly in need of protection and guidance."

An agency was obviously needed to give the certificate holders the benefit of expert legal and financial advice in reorganizing their mortgage certificate investments.

Activity of the Mortgage Commission

Thereafter, the Legislature created a new State agency known as The Mortgage Commission of the State of New York (*McKinney's New York Unconsolidated Laws,* Secs. 4801-4851), which commenced its activities in May, 1935. It was created for the purpose of administering the certificated issues, as successor to the Superintendent of Insurance. It was believed that it would be to the best interests of the certificate holders to have an agency administering the collateral which would not be encumbered with other duties. In order to facilitate the effectuation of reorganization plans which continued to require Court approval and the assent of two-thirds in amount of certificate holders, this statute provided "that assent to the plan need not be expressed affirmatively but that dissent from the proposed plan must be filed in writing and that those who fail to do so 'shall be conclusively deemed to have assented'" (*Matter of Mortgage Commission—1175 Evergreen Avenue,* 270 N. Y. 436, 442, aff'd *sub nom Lauro* v. *Barker,* 299 U. S. 521).

This statute likewise made available to the Court the judgment and experience of the administrative agency charged with the administration of these investments by providing for the submission by the Commission to certificate holders and the courts of plans involving extension and modification of mortgages coupled with the appointment of trustees to take over the permanent administration of the mortgages.

The Mortgage Commission reorganized during the period from May 1, 1935 to March 31, 1939, more than 13,500 mortgages whose aggregate principal was more than $583,000,000. Included in the latter figure is the amount of approximately $125,000,000 in mortgages which were in process of reorganization at the time of the turnover of these mortgages to the Mortgage Commission by the Superintendent of Insurance. Almost all of these reorganizations took place in the Supreme Court through the means

of the appointment or election of permanent trustees. The reorganizations were effected pursuant to the Schackno or Mortgage Commission Acts. In addition, there were principal reductions and cash liquidations on mortgages having a principal amount of $41,032,890.06 (*Annual Report of the Mortgage Commission,* April 1, 1939; Leg. Doc. 1939, No. 94, p. 17; *The Administration of Delinquent Title and Mortgage Guaranty Companies,* supra, p. 43).

The trustees so appointed or elected were similar in character to the respondent herein and act under declarations of trust similar to that which appears in this record (pp. 22-37).

The Legislature terminated the existence of the Mortgage Commission as of September 30, 1939, because it had promulgated reorganization plans with respect to more than 95% of the properties subject to its jurisdiction and had concluded the tasks imposed upon it by statute with respect to these reorganized mortgages (New York Session Laws of 1939, Ch. 944, Sec. 1). At the termination of the activities of the Mortgage Commission, the combined efforts of the two State agencies had resulted in liquidations and reorganizations of mortgages in excess of $800,000,000 in face amount. This left a balance in the approximate principal amount of $12,000,000, which was turned back to the Superintendent of Insurance on September 30, 1939. Between that date and September 30, 1942, he disposed of all but $2,141,197.59 of these mortgages, for the most part through reorganization by appointment of permanent liquidating trustees, pursuant to State statutes (Monthly Report of the Superintendent of Insurance Showing Disposition of mortgages, dated October 2, 1942).

The State has directly contributed approximately $2,000,000 of its own funds for the relief of certificate holders. This does not include the time and energy given to this task by the Superintendent of Insurance and other government officials and judges specifically assigned.

Between 1935 and 1939 New York State appropriated $1,330,950 from the general funds to cover the expenses of the Mortgage Commission which could not be directly allocated to any particular mortgage (see L. 1935, Ch. 56; L. 1936, Ch. 360; L. 1937, Ch. 125; L. 1938, Ch. 20; L. 1939, Chs. 460, 928). Two revolving funds, totaling $1,100,000, were also set up, to be used by the Mortgage Commission in reorganizing non-income producing properties (L. 1935, Ch. 290; L. 1937, Ch. 328). Without this fund, millions of dollars would have been lost by many thousands of certificate holders (Leg. Doc. 1938, No. 60). As of March 31, 1942, $761,973.13 was still outstanding in loans against these properties, much of which will never be collected. No interest was charged by the State for these loans. From 1939 to August, 1942, the State appropriated $325,000 for the use of the Superintendent of Insurance to conclude the work of the Mortgage Commission.

Activity of the Supreme Court of the State of New York

The judicial branch of the State Government co-operated in carrying out the comprehensive program of the State. In order to provide for uniformity of administration in reorganizing these certificated mortgages and in creating liquidating trusts, specific judges were designated by the Appellate Divisions to hold additional Special Terms of the Supreme Court in the respective judicial departments.

The Supreme Court, which was charged with the immediate responsibility for approval of these plans, decided that the rights of certificate holders would be better protected by vesting all the rights which an individual owning these bonds and mortgages would have, in trustees, rather than a corporation, because that would establish a fiduciary relationship and retain the right of supervision with the court (*Matter of New York Title & Mortgage Co.*, 153 Misc. 858, 864-866; *The Administration of Delinquent Title and Mortgage Guaranty Companies*, supra, p. 40; see also, *Matter of New York Title & Mortgage Co.*, 154

Misc. 447; *Matter of Lawyers Mortgage Co.*, 264 N. Y. 244). Express statutory authorization had been provided for the creation of such trusts (New York Session Laws of 1934, Ch. 920; New York Real Property Law, Sec. 96, subd. 5).

In the Second Judicial Department, out of which the present case arises, Mr. Justice George E. Brower was designated as the Justice to hear these matters, and has presided over all such proceedings from 1934 to date. Mr. Justice Brower, in almost all instances, except where a large majority of certificate holders, or one hundred percent of the certificate holders have requested appointment of individual trustees, has appointed corporate trustees of standing (Leg. Doc. 1939, No. 94, p. 7). These trustees have been appointed under a general plan of reorganization with a uniform Declaration of Trust, which was devised after much study and many conferences between the Court, the Mortgage Commission, the Insurance Department and attorneys familiar with this field of work. The form of such Declaration of Trust is set forth in the record (pp. 22-37). As appears in the Declaration of Trust, the purpose of the trust is to liquidate the mortgage investments as rapidly as possible; this liquidation to take place through amortizations on extensions, sales and satisfactions, all of which are, by the terms of the trust instrument, subject to the approval of the Court on notice to certificate holders. The trustee's fees are fixed by the Court within the annual maximum of ⅓ of 1% of the unpaid principal amount as fixed by the Trust Declaration and no attorneys' fees are permitted except in connection with court proceedings, and only if approved by the Court. The trustees are required to account annually. (See Report of Bureau of Trust Supervision, pp. 7, 8; *McKinney's Unconsolidated Laws*, Sec. 4815.)

The Declaration of Trust used in these cases has been described in the Report of the Securities and Exchange Commission, prepared by Mr. (now Justice) William O. Douglas, as follows:

"An unusually active type of trusteeship exists in New York State, in connection with the reorganization of issues of guaranteed mortgage certificates. Under the standardized form of declaration of trust * * * the trustee purports to be under a higher standard of obligation to the security holders than trustees under other indentures. Furthermore, he has expressed authorization to perform a broad range of acts looking toward future reorganizations. This type of trusteeship has developed out of a situation of unique complexity and peculiar difficulty. However, many features of the trusteeship itself seem to have no inherent restriction either to the type of security or the type of procedure wherein it originated, and it is therefore a suggestive analogy for other trusteeships, particularly in the field of real estate securities." (*Report on the Study and Investigation of Reorganization Committees*, Part VI, p. 185.)

The Bureau of Trust Supervision

With the termination of the Mortgage Commission and the trusteeing of almost all of the certificated mortgages, the judges assigned to this work became vested with the responsibility of supervising the operation of the liquidating trusts. The Schackno and Mortgage Commission Acts had fully served their purpose in accomplishing reorganizations of the issues. In order to continue the supervision of the issues, a currently operating method had to be established. By Chapter 704 of the Laws of 1940, the Legislature authorized the courts to appoint, and at pleasure remove, one or more competent persons to examine into all matters relative to these trusts. Pursuant to this statute, Mr. Justice Brower created the Bureau of Trust Supervision to assist him in the supervision of the trust estates within his jurisdiction.

There will be provided for the Court upon argument copies of the Report of the Bureau of Trust Supervision, which is on file in the Office of the County Clerk of the County of Kings (file No. 5791/1940). This report sets forth with particularity the method of operation of that

Bureau. We submit that this report amply demonstrates that the State of New York, through its judicial branch, is affording to the certificate holder creditors a high measure of protection, and that the interests of these creditors can be best subserved in continuing the present method of supervision in the State Courts.

The Report of the Bureau of Trust Supervision clearly demonstrates that it is well equipped as an agency for the protection of creditors. Its personnel is experienced, and competently trained to handle the problems. The Bureau has the advantage of close cooperation with the State agencies which have heretofore administered these issues. More important, there is the necessary continuity in the administration of the properties. There is more to the proper administration of mortgages and real estate than appears on first examination. The past history of the properties is most important. All of the information compiled over the past ten years on each of the properties is available to help the Bureau reach a conclusion as to the most advisable method of reorganization.

The main functions of the Bureau of Trust Supervision fall into two principal categories: (1) the examination and audit of the annual and final accountings rendered by trustees and the making of reports in connection therewith; (2) the examination and analysis of applications by trustees, owners, certificate holders and other interested parties relative to the sale of real property, liquidation and extension of bonds and mortgages and miscellaneous applications for instructions and the making of reports to the Court relative thereto.

Another very important function is the direct service that it renders to certificate holders, of whom there are more than 150,000 holding investments in mortgages, in the Court in which this Bureau functions. The certificate holders have the advantage of having an agency to which they may go for information and advice, without charge to them.

We briefly summarize the volume of work which passes through this Bureau: During the period from May 10, 1940 to June 30, 1942, there was considered by the Kings County Supreme Court and examined and reported on by the Bureau, a total of 1,986 motions or applications by trustees, property owners, certificate holders and other interested parties, exclusive of accounting matters. These 1,986 motions or applications involved an aggregate principal face amount of mortgages of $159,016,648.* It was necessary for the Bureau to make 3,201 appearances in court on these matters. The average number of such transactions is in excess of seventy-six per month. This work is constant, because of the provisions of the Trust Declarations which require Court approval of the important steps taken under these plans.

We respectfully invite attention to that part of the Bureau's report (p. 18) which shows a liquidation of collateral of the principal amount of $44,529,617.85 up to December 31, 1941, and to that part which shows that as of December 31, 1941 there were 5,084 mortgages totalling a principal amount of $197,827,559.73 in good standing, and 477 mortgages in principal amount of $14,319,519.46 in default. It also appears that during the calendar year of 1941, trustees made distribution to investors of $18,811,065.27 on account of principal and interest.

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*While the bulk of these motions was naturally made by the trustees, there were a number of applications made by other parties in interest and reported on by the Bureau and passed upon by the Court. For instance, there were twenty-four motions by owners of mortgaged real estate for varying relief such as modifications of plans, reargu-ments, etc., as well as several motions by prospective purchasers of real property to procure approval of offers to purchase, and by certificate holders to compel trustees to take action on proposals submitted to them,—all of which were determined by the Court on the merits. It may also be noted that during this period there were several appeals to the Appellate Division by owners of mortgaged premises, some of which resulted in reversals and some in affirmances. This is particularly relevant in view of the claim made below that the debtor had no voice in the State Court proceedings.

The total cost of operating the Bureau for the period from May 10, 1940 to June 30, 1942 amounted to $69,554.92, or an average of $32,519.36 per year, or .011614 of one percent per annum of the estimated average principal amount of the mortgages under the jurisdiction of the Court during that period.

We respectfully submit that in dealing with a tremendous local problem of this nature it is highly advantageous that an agency such as the Bureau of Trust Supervision should be geographically located where the problem exists. There are many other facts contained in the report of the Bureau which demonstrate the extent of its work and the efficiency with which it is done. We believe that the Bureau of Trust Supervision is an agency which is fully competent to afford to the public all of the protection that can possibly be rendered by any agency, including the Securities and Exchange Commission. All of the powers which the Securities and Exchange Commission claims that it has, are here present in a larger degree. The Commission's contention that no adequate measures exist in the State Court to protect the rights of the parties to these proceedings, fails in these statutory and purely local proceedings where a comprehensive program for the complete and inexpensive protection of mortgage investors has been established.

Administration of these liquidating trusts should be left with the State Supreme Court to be administered with the advice and guidance of the Bureau of Trust Supervision and of the other agencies and trained personnel in other departments.

We have placed emphasis upon the protective devices taken by the Supreme Court in the Second Judicial Department because that is the Department out of which this litigation arises. Other Departments having to do with these problems have taken equally adequate measures, by means of trained personnel, to protect the interests of the public.

State Court Proceedings versus Chapter X Proceedings

We are mindful of the fact that Chapter X states that for a petition to be dismissed, it must be shown that the interest of creditors would *best* be subserved in the prior proceeding and that, therefore, it may be argued that it is not sufficient to show that the State Court proceedings are fully adequate in themselves. The statute is such that the argument might be made that it must appear, *after comparison*, that the State proceeding is best for creditors.

In the first place, the burden of showing that the State proceeding will *not* best subserve creditors' interests is on the petitioner—not respondent (see Respondent's Brief, pp. 9-10).

We further contend that in a case such as the instant one, in which the debtor has no assets other than a piece of mortgaged real estate, wherein the amount of the mortgage is in excess of the appraised value of the real estate (Record, pp. 17-20) and where the local problem involved is one which has been described by the Securities and Exchange Commission as of "unique complexity and peculiar difficulty" (Securities and Exchange Report, Vol. VI, p. 185), a comparison of the State and Federal proceedings will indicate that the State proceeding will best serve those interests.

The situation as it exists in this case is by far the most common situation in the reorganization of certificated mortgages in New York. All of the certificated mortgages were placed upon the properties involved prior to February, 1933, at a time when higher real estate values existed and, in turn, larger mortgages were the rule and not the exception. Such properties were almost invariably the only asset of the corporate owner. With the deflation of the value of real estate to lower levels, it followed that in very many cases the amount of the certificated mortgage was found to be in excess of the true value of the property it encumbered.

There has been little or no experience of reorganization of certificated mortgages under Chapter X, whereas under

the State Court procedure, any analysis of its desirability can be implemented by the experience of some nine years of work (see *Bureau of Trust Supervision's Report*). An analysis of Chapter X for this purpose must be limited to the Act itself. Although a lack of experience is not necessarily controlling, it should be a very weighty factor in a field as complex and peculiarly local as this one.

The State of New York has recognized its responsibilities to the hundreds of thousands of holders of certificates, has invested large sums of money for the creation of agencies to protect them, and through these expenditures has trained competent personnel who are familiar with the history of the mortgages involved and with the details of the problems presented. This personnel continues to exercise supervision for the benefit of certificate holders through the Bureau of Trust Supervision in Kings County and through other personnel in other counties. The judges, such as Judge Brower in Kings County, have had years of experience with these mortgages. Complete files running from the inception of the mortgages, taken from the files of the guaranty companies, running on through the period of supervision by the Superintendent of Insurance through the period of supervision by the Mortgage Commission and now into the period of supervision by the Bureau of Trust Supervision, are available to the Bureau and to the courts. We fail to see how anything but disadvantage can result from upsetting this smooth-working mechanism and transferring these mortgages to the jurisdiction of the Federal Court.

In those instances in which the Securities and Exchange Commission would be made a party, its personnel would not necessarily be trained in mortgage or real estate problems.* Their experience is with security issues and large

* The Securities and Exchange Commission must be made a party only in those proceedings wherein three million dollars or more are involved (11 U. S. C., Sec. 572). There are no certificated mortgages involved in Schackno proceedings whose amounts total three million dollars.

industrial corporations. While it has been argued that disinterested trustees would be appointed in many instances, it must be remembered that Chapter X only provides for disinterested trustees when the principal amount of the mortgage exceeds $250,000. (11 U. S. C., Sec. 556.)

An examination of the files shows that at least 75% of Schackno mortgages are less than $250,000 in principal amount. The result would be that either the debtor itself would remain in control under Chapter X to the decided detriment of certificate holders, or a trustee would be appointed. After that individual was appointed trustee, he would have to formulate a plan of reorganization which would necessarily follow one of two alternative courses: first, the formation of a corporation in which certificate holders would become stockholders and which would take title to the property, or second, the sale of the property to an outsider. The disadvantage of the corporate form of reorganization and the arguments in that respect are set forth fully in the trustee's brief, pages 23-24.

See also:

In re Lawyers Westchester Mortgage & Title Co., Sup. Ct., Westchester Co., N. Y. Law Journal, Feb. 7, 1934;

In re N. Y. Title & Mortgage Co., 153 Misc. 838.

If the alternative of sale were adopted, the individual trustee appointed in the Federal Court would not necessarily effectuate a sale of the property as advantageously as would the corporate trustee, who had previously administered the property in question and who was familiar with its history. Moreover, any such plan would not have the advantage of examination by the State Court, which has all of the records and history of the particular property and of similar properties, available to guide it in passing upon the fairness or desirability of the plan; nor would it be subject to the recommendation of the Bureau of Trust Supervision, which has similar records and experience.

In addition, as pointed out in the trustee's brief (pp. 27-31), the expense of a Chapter X proceeding is prohibitive in comparison with the expense of the reorganizations in the trust proceedings in the State Court. See, *In re Castle Beach Apartments, Inc.*, 135 F. (2d) 762; *In re Frank Realty Co.*, 31 Fed. Supp. 816.

Other mechanical difficulties would arise in the Federal Courts. In a group issues (see *Paloma Estate* case, action in *certiorari* held in abeyance May 12, 1942), where there are more than 100 mortgages and properties and more than 7,500 certificate holders, under Chapter X the 7,500 certificate holders would have to be parties to the proceeding with the attendant enormous expense of several printings and mailings. The remainder of the mortgages would nevertheless still be subject to the jurisdiction of the State Court and its trustee with needless confusion, duplication and overlapping of effort.

Both the District and Circuit Court Justices in the Southern District and Second Circuit, respectively, have recognized these problems and have permitted the administration of Schackno mortgages to remain in the State Courts.

Jacoby v. *Bond & Mortgage Guarantee Co.*, 72 F. (2d) 420, cert. den. 293 U. S. 619;
Tolfree v. *New York Title & Mortgage Co.*, 72 F. (2d) 702, cert. den. 293 U. S. 619;
Depew v. *Lawyers Title & Guaranty Company*, 72 F. (2d) 705, cert. den. 293 U. S. 619;
Brooklyn Trust Co. v. *Rembaugh*, 110 F. (2d) 838;
In re Paloma Estates, Inc., decided Feb. 21, 1942 (Judges Learned Hand, Chase and Clark) unreported;
In re Blinrig Realty Corp., 114 F. (2d) 100.

See also:

Francfair, Inc., 13 F. Supp. 513 (S. D. N. Y.);
In re Reliable Estates, 33 F. Supp. 588 (E. D. N. Y.);
In re Coney Island Hotel Corp., 76 F. (2d) 126.

We, therefore, see no reason why these Schackno trusts should be terminated in the State Court and brought into the Federal Court. If that is done, ten years of progress by New York State in the solution of these difficult problems will be seriously impeded, to the detriment of the certificate holders, practically all of whom are citizens of this State. We agree with Mr. Justice Douglas who said, when discussing state control in wage earner bankruptcies:

> "It seems desirable * * * to utilize to the fullest possible extent the administrative procedures and techniques which states have evolved or with which they have gained experience. The alternative of raising a new and huge federal superstructure to handle a function of some familiarity and experience in the states seems unwise" (42 Yale Law Journal 637).

See also:

Pennsylvania v. *Williams*, 294 U. S. 176.

We, therefore, respectfully submit that the order of the United States Circuit Court of Appeals should be affirmed.

Respectfully submitted,

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